Lecture 1:

Introduction

Thibault FALLY

C181 – International Trade

Spring 2018

About me:

- How to pronounce Thibault: “Tebow”
- I grew up in Paris
- Studied: at the Paris School of Economics (PhD), Harvard and Ecole Normale Superieure
- 4 years as an assistant professor at the University of Colorado-Boulder
- Moved to Berkeley 4 years ago
- Now: Assistant Professor at the Department of Agricultural and Resource Economics (ARE)

My area of expertise:

- International Trade

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- International Trade
- More specifically:
  - Preferences and income effects
  - Supply chains
  - Multinational firms
  - Gravity equations and the role of distance
  - Wage inequality
  - Financial constraints
  - Outsourcing vs. integration
- More info on my research on:

http://are.berkeley.edu/~fally/

Introduction

- Course outline:
  - Methods and Topics
- Course requirements
  - Grading, exams, problem sets
- International Trade?
  - Some basic facts

Main topics

In this course, we will study international trade in goods and services.

We will learn the economic forces that determine what that trade looks like:

- what products are traded?
- who trades them?

  (which countries? which firms? worker types?)
- what the benefits and costs of trade?
- Impact of trade on inequality?

We will also learn about policies that governments use to shape trade patterns.

“Policy”: recent examples

Trade liberalization:

- GATT (Uruguay round), now called WTO
- Unilateral trade liberalization
- Demise of communist bloc
- NAFTA (and current renegotiations)
- TPP, TTIP, CETA
- Brexit

Opening to Foreign Investment:

- Most rich countries
- Eastern Europe
- East Asia, etc.

Think “General equilibrium”

One of the main goal of this course:

Train you about thinking in terms of *general equilibrium*

Various markets adjust at the same time:

- **import-competing vs export-oriented goods markets**
- **Labor markets for different type of workers**
- **Capital markets, markets for land**
- **Trade balance, etc.**

If you focus on a one market and ignore adjustments in the others, you will likely get to the wrong conclusions

Road map

Based on the BOOK:

By Robert **Feenstra** and Alan **Taylor**

"International Trade"

2nd , 3rd or 4th Editions (very few changes between editions)

Exceptions: Chapter on Imperfect competition plus some other details (additional lectures notes will then be posted online)

Road map

- Introduction:

Where is the course going? What are the fundamental issues? (Ch 1)

- Comparative Advantage:

Why do country differences create gains from trade?

How does trade affect income distribution? (Chapters 2-4)

- Multinational Firms and FDI:

What effect does foreign investment have on wages?

Why do some firms become multinationals while others do not? (Chapter 5)

- Offshoring, Trade and Wages:

What is offshoring?

How is this trend different from earlier trends in globalization? (Chapter 7)

Road map (cont'd)

- Increasing returns to scale & Imperfect Competition:

Does trade reduce monopoly power? What are the gains from increasing variety of consumption goods? Why is free trade w Canada is less controversial than free trade with Mexico or China? (Chapter 6)

- Trade Policy:

What types of policies affect international trade and how? How trade policies of one country affect well-being in another? (Chapters 8 – 10)

- Political Economy:

Why countries do not maximize welfare?

Why some interest groups are favored over others?

- International Trade Agreements:

What to make of the WTO? What to make of NAFTA? Why do we or do we not need agreements like the Kyoto protocol, TPP or TTIP? (Chapter 11)

Today:

- Course outline:
  - Methods and topics
- Course requirements
  - Grading, exams and problem sets
- International Trade?
  - Basic facts and definitions

Prerequisites

Intermediate Macro and Micro (100A&B or 101A&B)

Especially **micro**economics:

- Indifference curves
- PPF
- Consumer welfare
- Firm behavior, returns to scale, etc.
- But also some macro (e.g. MPL, MPK, w, r)

Not a lot of calculus but definitely some math (algebra)

Grading

1) Midterm: 25% each (*)
   - Wednesday, February 28th
   - Wednesday, April 18th

2) Final exam: 30% (*)
   - Friday, May 11th, 3 pm

3) Assignments (4 problem sets): 20%, i.e. 5% each

(*) If your final exam is better than your worse midterm, the final counts for 55% and your worse midterm is dropped:

Weights	First midterm	Second midterm	Final exam	Assignments
Baseline	25%	25%	30%	20%
Alternative 2	25%	0%	55%	20%
Alternative 3	0%	25%	55%	20%

Clickers

What for?

- ***For you:*** test whether you got it:

→ Sometimes you may think that you follow…

…until you get a wrong answer!!

→ Some quick training for the exam

- ***For me***: check whether you follow and whether a point needs more explanation

Clickers

Clicker grade?

- Don’t sweat it out: everyone should have a clicker, but attendance is not mandatory
- I will compute a grade from the clicker participation,
  But this will only count as an **optional** assignment:
  - **It will not count** if your clicker grade is below your assignments grade
  - Counts only if clicker grade improves your average grade for assignments, by replacing your worst/missing assignment

How should you learn?

In class:

- Take notes (preferably no computer)
- No multi-tasking
- Answer clicker questions
- Go to the sections

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At home:

Go back and forth from exercises to lecture notes

- When you can't do an exercise, check your notes
- For each key part of the course, check several exercises (see list of key points before each exam)
- **Assignments** every two or three weeks

Attendance

- Attendance counts only through the clicker grades
- And thus it is NOT mandatory

HOWEVER:

- I observe a strong correlation between attendance and grades
- Studies have also pointed out a causal link between the two (even when attendance is not part of the grade)

➔ I will try to stimulate several ways to retain the material:

- **Visual memory**: slides + graphs + calculation on blackboard
- **Verbal memory**: repeating important points + careful with accent
- **Active learning**: clicker questions + other questions in class

First problem sets

First PS already available on bcourse:

- Review of basic concepts from micro
- Ricardo for one country
- Terms of trade effects

Due February 5th

- Second problem set: due February 22nd
  (one week before first midterm)
- Third and fourth problem sets: before 2nd midterm
- Problem sets to be handed in pdf format

How should I teach?

Technology:

- Mostly slides: lots of graphs!

- Some of the math on the blackboard
  - But harder to do for a 200-students class

Structure:

- Same structure as the book in terms of chapters
  - With extra content on firms, multinationals and examples of trade liberalization episodes

- *But what matters for exams is what I do in class*

I like feedback!

- Class participation: ask questions, answer questions
  - That's why I use CLICKERS
- Interrupt me if you don't understand what I say
  - Accent reduction training takes time…
- Don't hesitate to come to office hours (GSI or me)
- **NEW THIS TERM:** Please post your question online (bcourse)
  - And come to office hours if the answer is not clear enough
- Raise a red flag if there is any issue
- There is (some) flexibility: if you would like to change something, we can work on it.
  - E.g. structure of exam, content of the lectures, etc.

Feedback from previous years

- What previous students liked about my course:
  - Nice slides
  - Use of economic theory to think about effect of trade
  - Examples taken from data and newspapers
  - Approachability, being open to feedback and improvements
  - Being close to the book? some people really liked it
  - Accent wasn't an issue, with few exceptions
- What we will try to improve:
  - Blackboard for the math + graphs (improve writing)
  - Going faster during lectures?
  - Problem sets and sections: relation to exams
  - Lack of confidence

Diversity:

- Students in this course are more diverse than you think
- …In dimensions that are particularly relevant to the course:
  - Many of you (and me) are foreigners.
  - Immigrants or related to immigrant
  - Some have family who lost their jobs before of trade
  - Some from China, etc.
- Please be respectful
  - People here are from the whole political spectrum
- I will often talk about politics
  - Trade is highly policy relevant these days
  - I will talk about the view of the majority of economists in my field, those may or may not correspond to my own opinions
  - There is more agreement among economists than people think

Opinion in 2012 on…	Avg. American		Economists			
	Agreement	Uncertainty	Agreement	Uncertainty	Δ	Distribu
School vouchers to public school students	56.29	8.54	51.43	42.86	0.05	1
Benefits of automakers bailouts will exceed their cost	51.95	8.64	57.58	30.30	0.06	0
Risky student loans	61.05	19.81	69.70	27.27	0.09	1
2009 Stimulus: benefits will exceed its costs	43.42	12.41	52.78	33.33	0.09	0
Size large banks: efficiency versus government support	39.45	-	17.95	76.92	0.22	0
CEOs are overpaid	66.80	9.19	39.39	51.52	0.27	0
2010 unemployment rate was lower thanks to automakers bailouts	54.82	13.06	84.85	12.12	0.30	0
2008 bank bailouts: benefits outweighed costs	38.73	12.13	69.70	15.15	0.31	0
Raise in federal tax rate and tax revenues	66.39	7.91	97.44	2.56	0.31	0
Large banks: size and implicit government support	65.27	12.13	33.33	56.41	0.32	0
Fannie and Freddie do not rebate subsidies through lower interest rates	66.79	—	31.43	60.00	0.35	0
Changes in US gasoline prices mainly due to market factors	54.31	9.17	92.31	7.69	0.38	0
It is hard to predict stock prices	55.22	15.70	100.00	0.00	0.45	0
2009 ARRA lowered unemployment rate	45.63	13.00	91.67	2.78	0.46	0
NAFTA increased welfare	46.17	15.39	94.59	5.41	0.48	1
Eliminating tax deductions on mortgages improves efficiency in individual financial decisions	35.61	15.35	89.47	5.26	0.54	1
"Buy American" has a positive impact on manufacturing employment	75.65	9.27	11.43	31.43	0.64	1
Healthcare sustainability	67.61	10.24	0.00	15.15	0.68	1
Carbon tax versus car standards	22.51	13.81	92.50	5.00	0.70	1

Miscellaneous:

Course website: bcourse

- Lecture slides
- Problem sets + other exercises
- Check regularly for announcements!
- Online discussions (e.g. on exam topics, news, etc.)

News:

- Check the Economist, NYT, WSJ, etc.
- Don’t hesitate to ask news-related questions or point to interesting articles that could be interesting for all.

GSI's and sections

- Go to the Sections
  - **Attendance taken the first week** (administrative drops)
  - No attendance taken formally otherwise
- Good training for the exams and assignments
- I interact with the GSI's to get continuous feedback on your knowledge and progress
- Three excellent GSI's to help you this term:
  - ISABELA
  - SERGII
  - JAMES (JAY)

Contact

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Now:

Some facts about international trade…

…. And various misconceptions

Definitions

- Exports:

Product sold from one country to another.

- Imports:

Product purchased by one country from another.

- Trade surplus (resp. deficit):

Total exports minus imports (resp. imports minus exports)

- Foreign Direct Investment (FDI):

Investment and control in overseas affiliates

Note: C181 is not about exchange rates.

Exchange rates, trade imbalance, etc. are the topics of Econ 182

A Misconception

"We live in a globalized world where international trade has become largely predominant."

REALITY:

- There is not that much trade compared to domestic (local) transactions
- Especially the US
- Data: the ratio of **Trade/GDP is small** for most countries

Note:
Ratio can be > 100%
for some countries

Data (2010):
(Import + exports) / GDP

Country	Trade/GDP (%)	GDP ($ billion)
Hong Kong (China)	216	229
Singapore	193	213
Malaysia	85	247
Hungary	83	129
Thailand	68	319
Austria	52	377
Denmark	48	313
Sweden	46	463
Switzerland	46	552
Germany	44	3,284
Norway	35	418
United Kingdom	32	2,256
Mexico	31	1,035
Canada	30	1,577
China	29	5,931
Spain	28	1,380
Italy	28	2,044
South Africa	27	364
Greece	27	292
France	27	2,549
Russian Federation	26	1,488
India	25	1,684
Turkey	24	731
Indonesia	24	708
Venezuela	23	394
Argentina	20	369
Pakistan	17	176
Japan	15	5,488
United States	15	14,419
Brazil	11	2,143

“Globalization” over the past decades:

- Increasing flow of goods
- Increasing flow of services
- Increasing flow of capital
- Increasing flow of information, etc.

What’s new?

- Magnitude of trade flows and capital flows,
- Communication technologies
- Fragmentation of production

(e.g. iphone production chain)

Forces shaping globalization

- **Technology**
  - Communication-enhancing
    - cell phones, email, internet, …
  - Productivity-enhancing
    - computers, containerization, …

- **Policy**
  - Trade liberalization
  - FDI liberalization
  - International migration

Yet… another misconception:

"Globalization is a new phenomenon."

REALITY:

- A first Globalization episode occurred in the late 19th century
- Great Britain, Shanghai, and various other regions were truly "globalized"

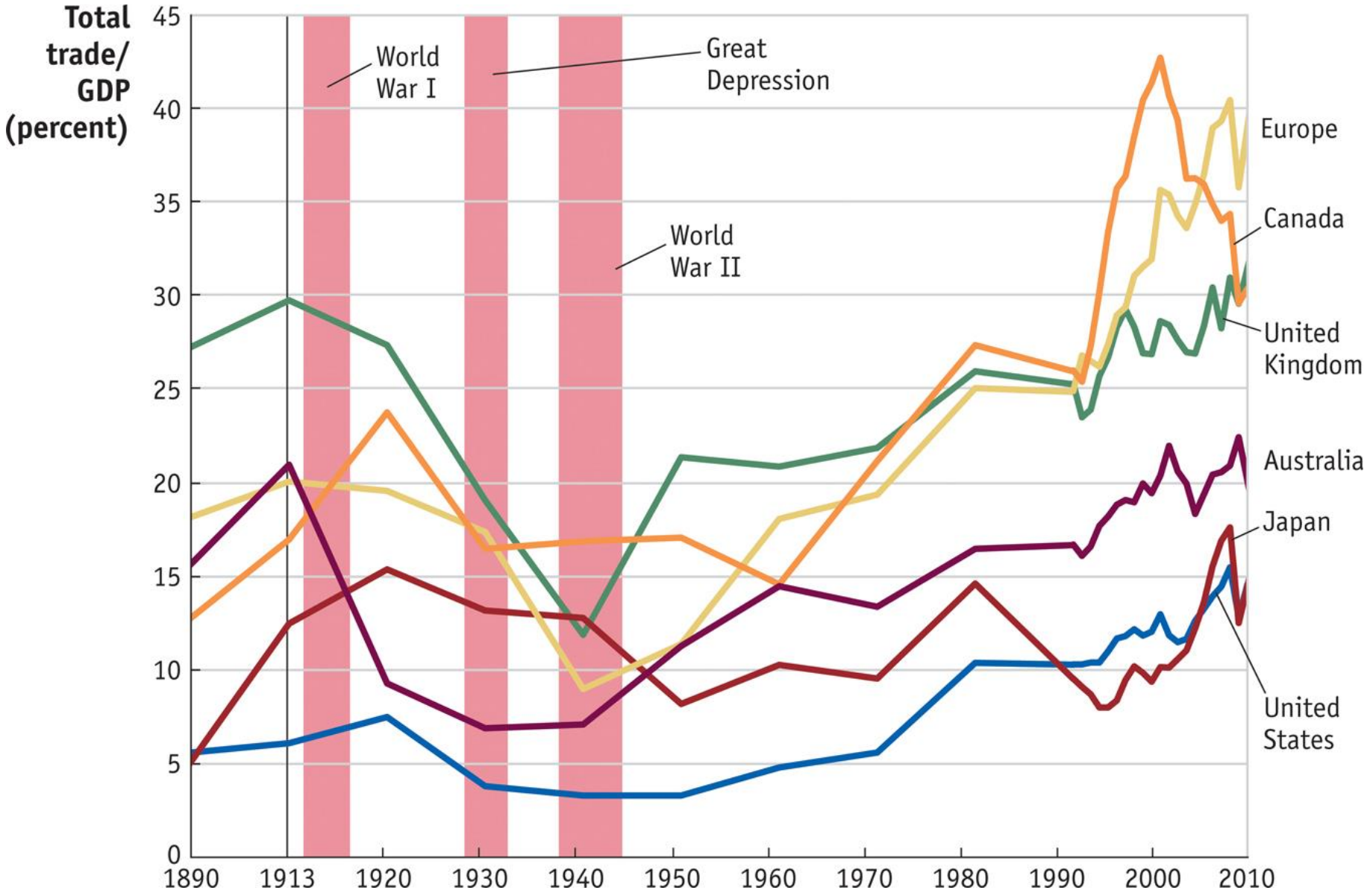


Figure 1.3 Trade in Goods and Services Relative to GDP

US Merchandise Trade, percent of GDP, 1869-1997

“First Golden Age” of Trade

The period from 1890 until World War I (1914–1918) is often referred to as a “golden age” of international trade:

Dramatic improvements in transportation

(e.g. steamship and railroad)

and communication (phone, telegraph)

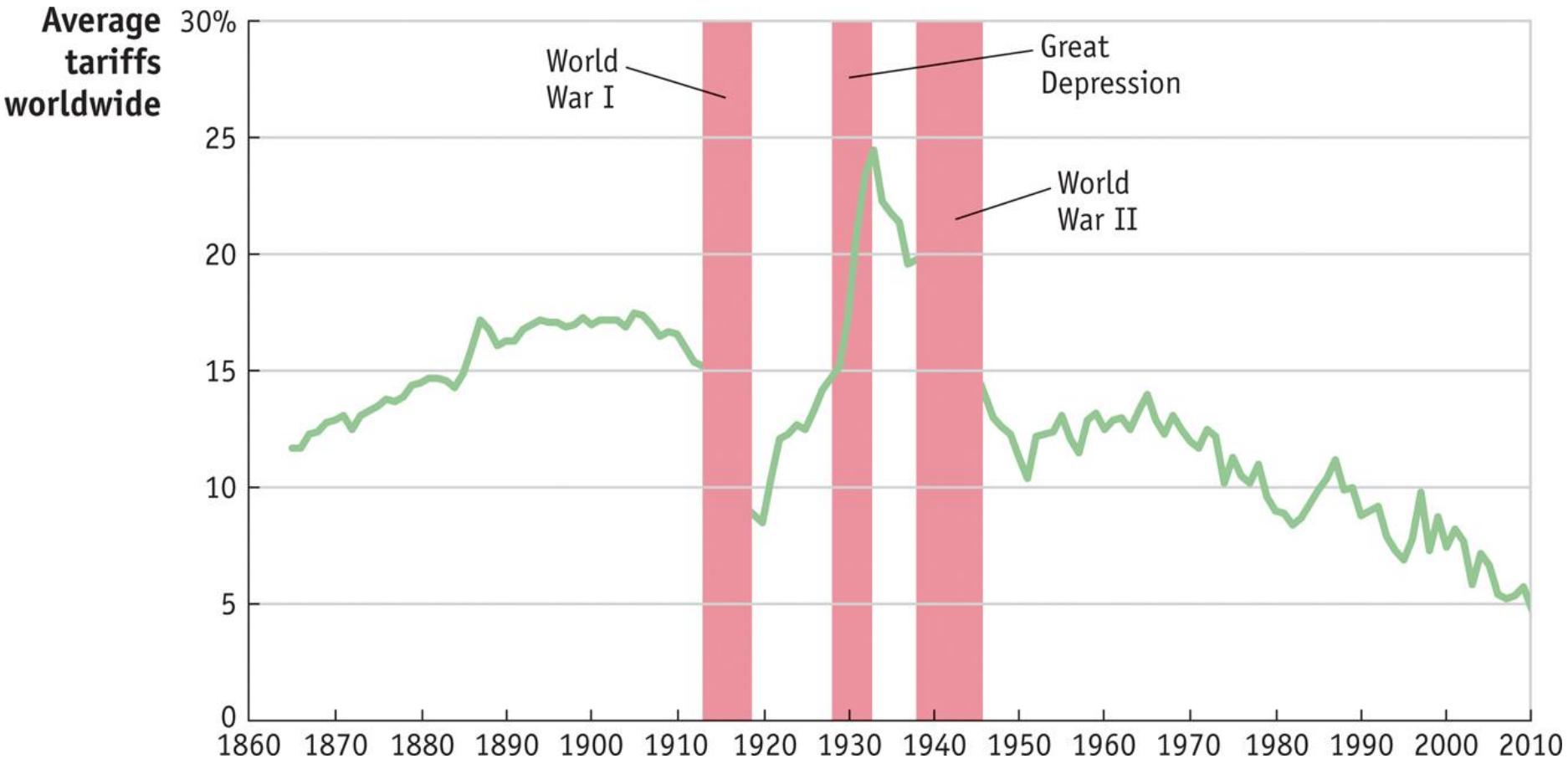


Figure 1.4 Average Worldwide Tariffs, 1860–2010

“Second Golden Age” of Trade

In addition to the end of World War II and tariff reductions under the *General Agreement on Tariffs and Trade*, improved transportation costs contributed to the growth in trade.

e.g. shipping container invented in 1956

World trade grew steadily after 1950 in dollar terms and as a ratio to GDP. For this reason, the period after 1950 is called the “***second golden age***” of trade and globalization.

What do we trade?

Misconception:

“we mostly trade consumer good such as food or iphones”

REALITY:

Most trade is industrial supplies and capital goods

(e.g. machinery)

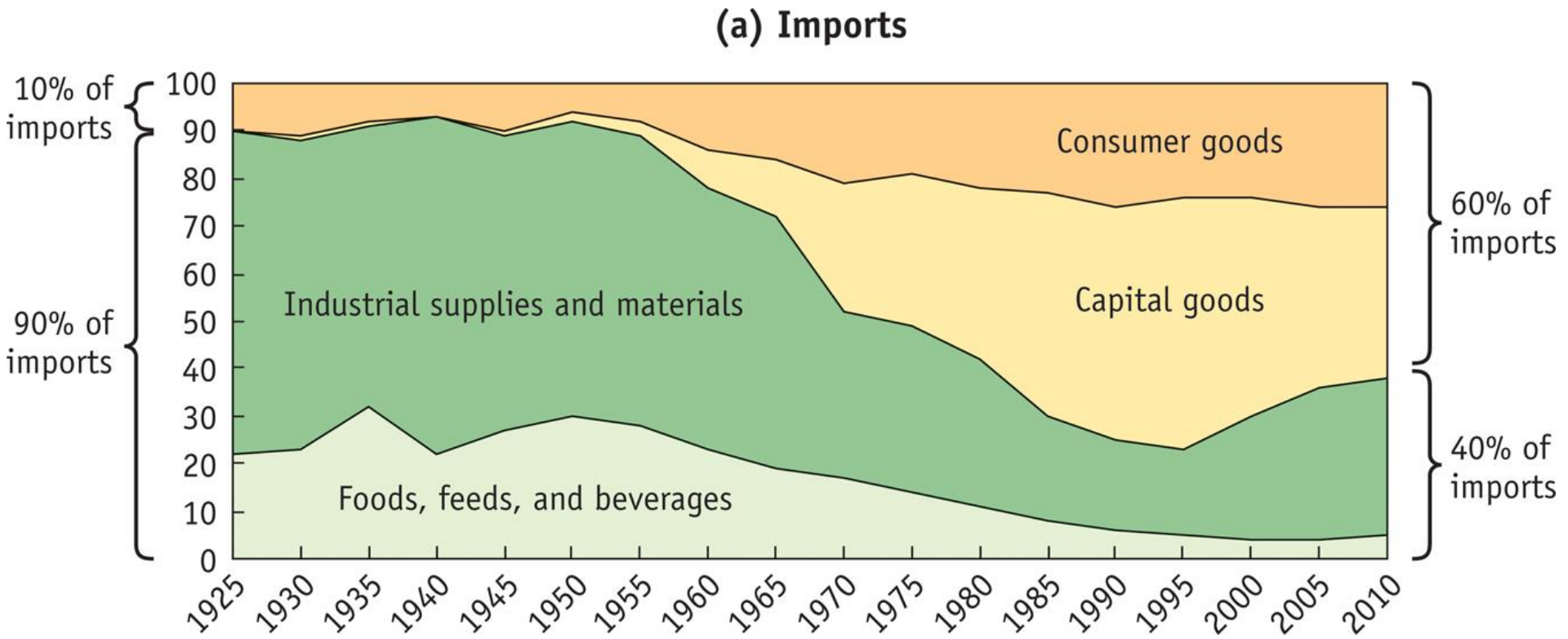


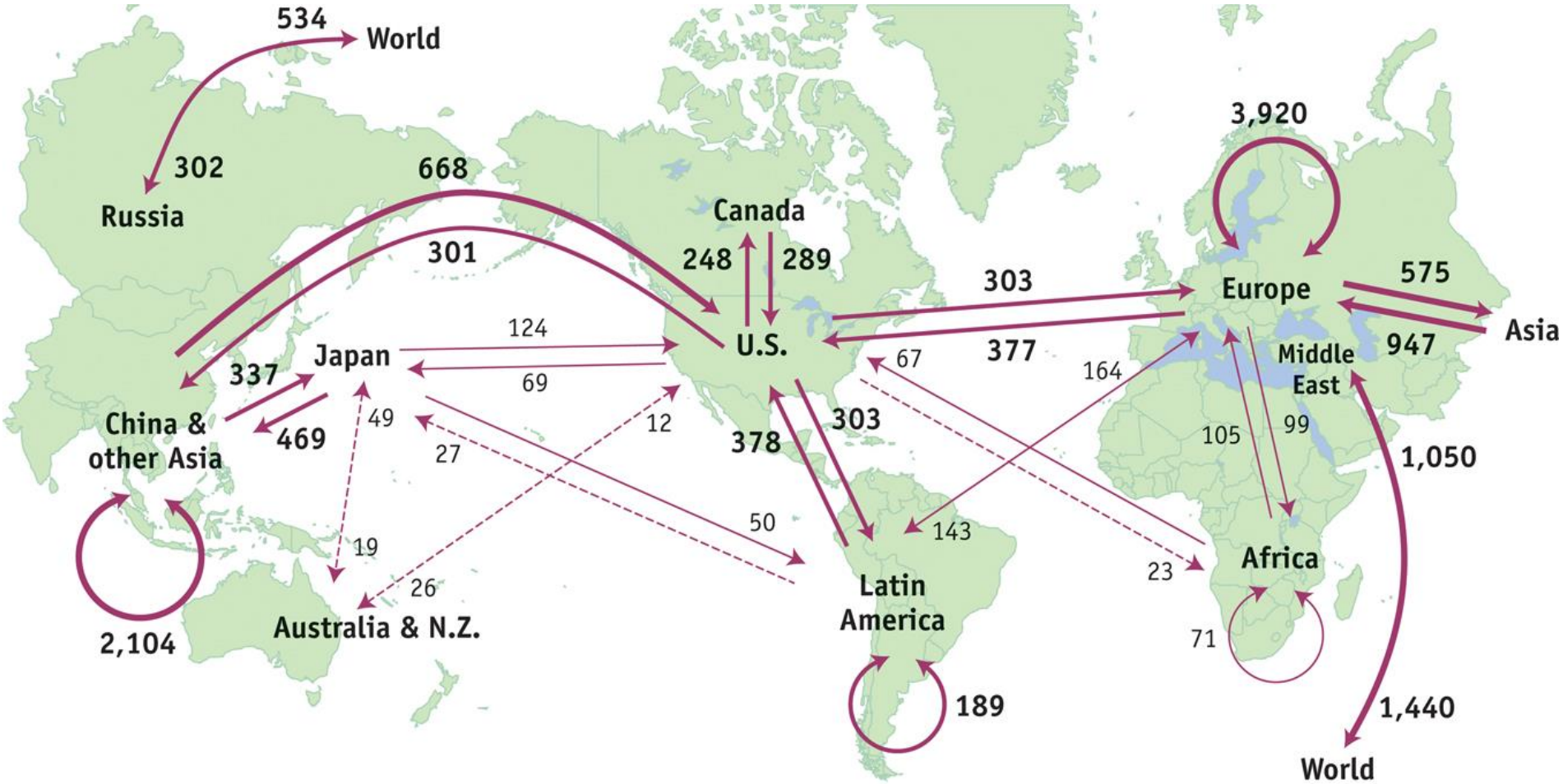
Figure 1.1 (a) The Changing Face of U.S. Import and Export Industries, 1925–2010

With whom do we trade?

Misconception: “we mostly trade with low-wage countries”

REALITY:

- Most trade is between **rich** countries



Total world trade flows in 2010: $16,800 billion

World Trade in Goods

- < $50 billion
- $50–150 billion
- $150–500 billion
- > $500 billion

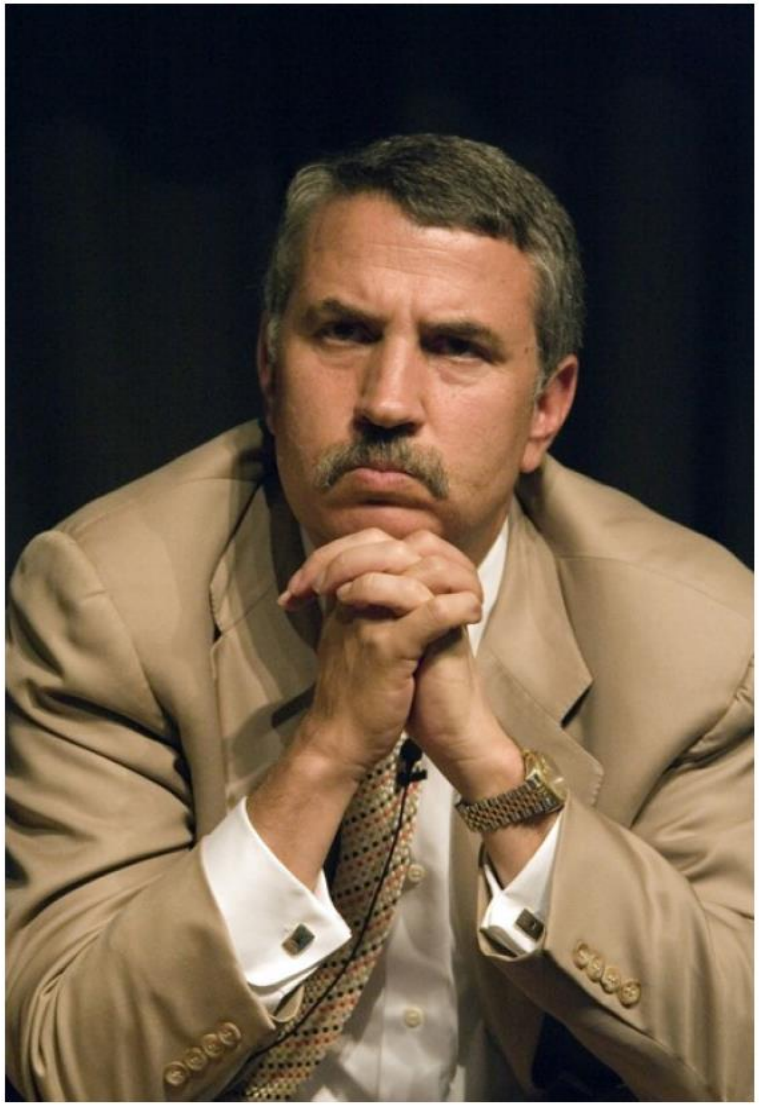
Distance and geography

Misconception: “The Death of Distance.”

REALITY:

- Trade is more sensitive to distance now compared to several decades ago

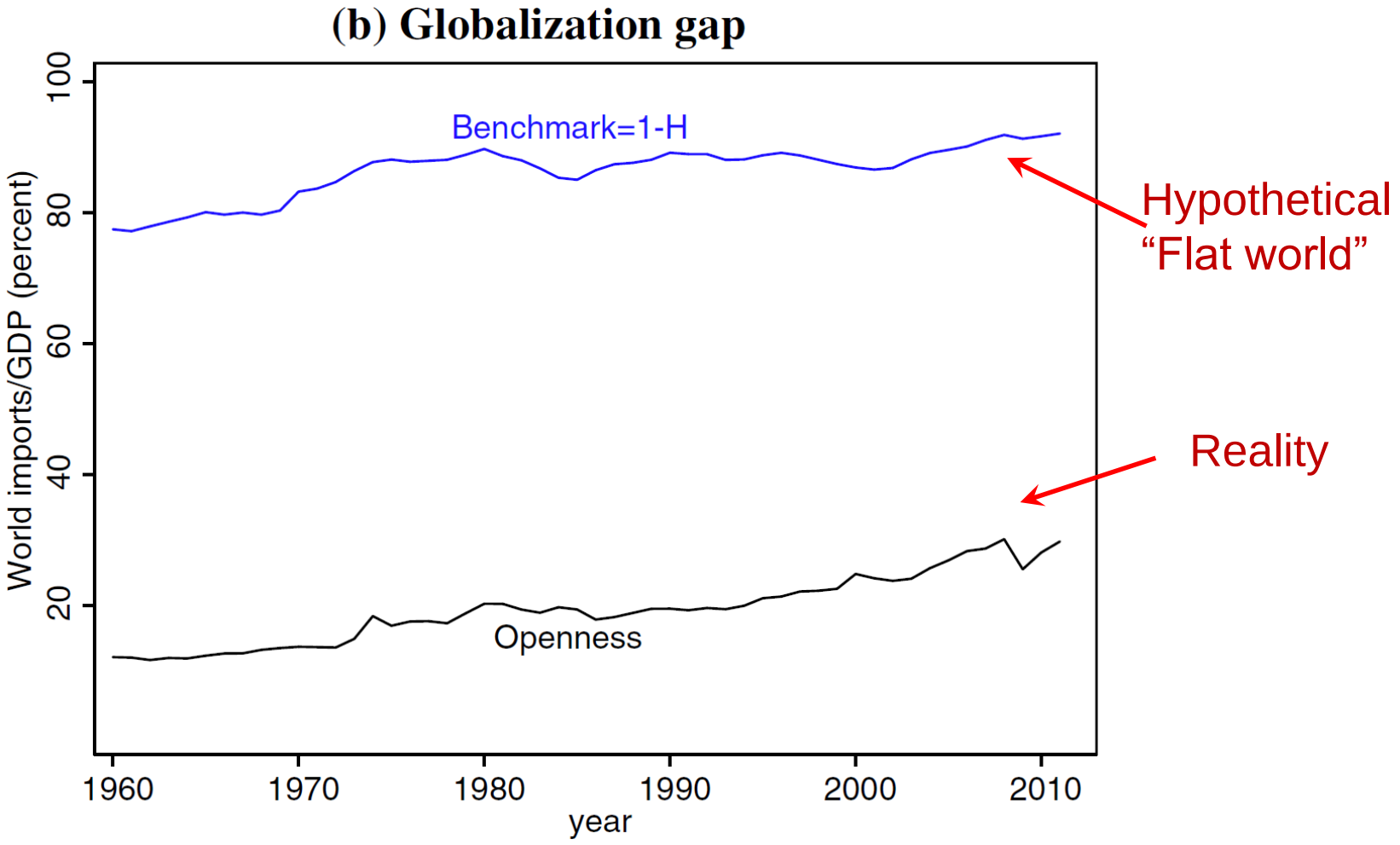
"The death of distance and the communications revolution will be among the most important forces shaping economies and society in the next fifty years or so."
-Frances Cairncross, *The Economist*



The world is flat?

- "...what the flattening of the world means that we are now connecting all the knowledge centers on the planet together into a single global network... "
- "Search engines flatten the world..."
- "Just as the national highway system flattened the US...and made it so much easier to relocate in lower-wage regions, like the South...the laying of global fiber highways flattened the developing world"

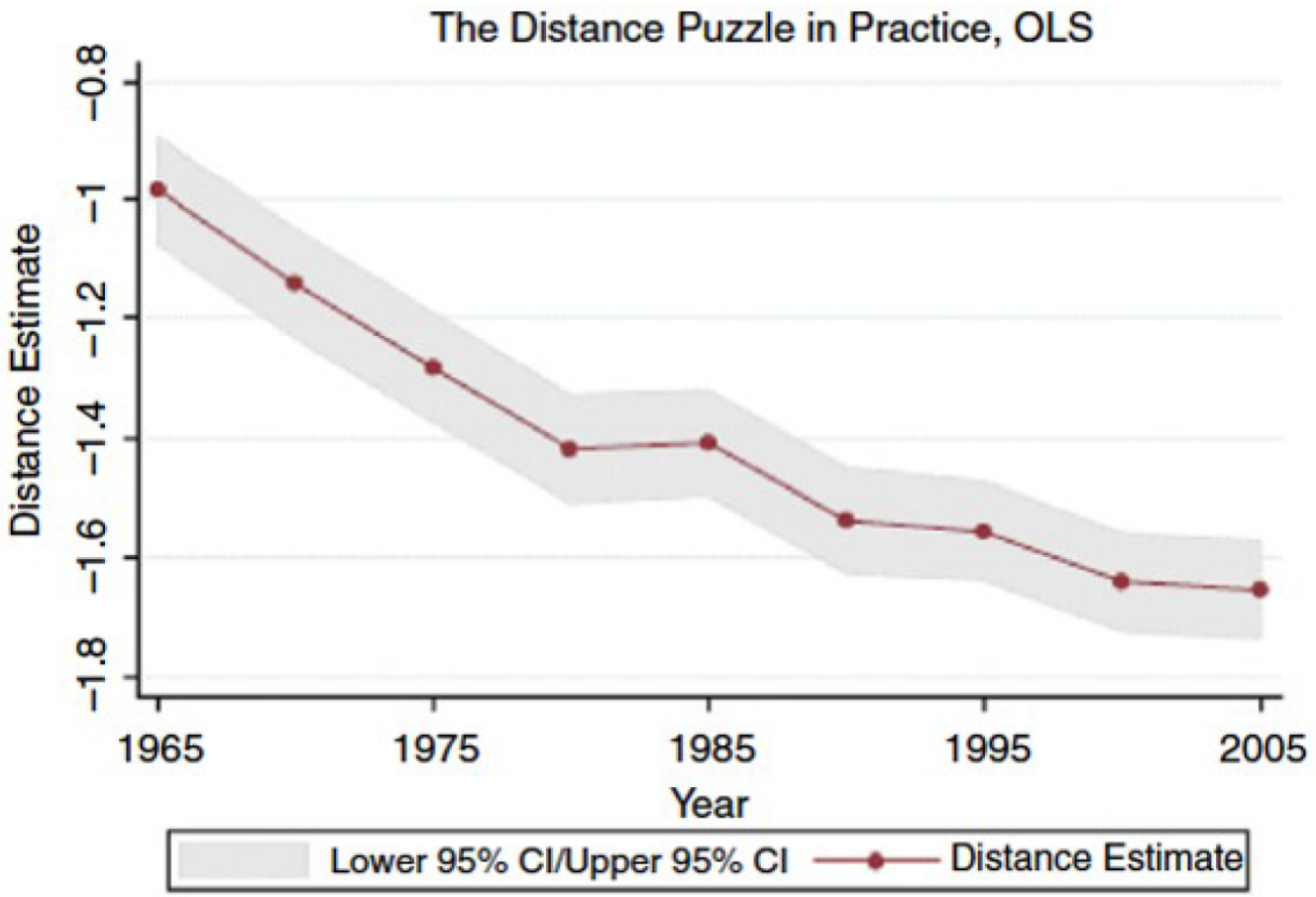
YET: Big gap between actual openness and what it would be without borders and without distance:



Source: Head and Mayer ("What separates us?" CJE 2013)

In the data:

The negative effect of distance on trade has increased



Yoto V. Yotov, Economic Letters 117 (2012)

Why distance matters

What "distance" may capture:

Cultural	Administrative	Geographic	Economic
Language	Colonial Ties	Physical distance	Endowments
Ethnicity	Regulation	Common borders	Market Size
Religion	Hostilities	Access to Ports	FX Volatility
Norms	Currency Regime	Climate	Infrastructure

Illustrating cultural distance: some mishaps

- Coors
  - "Turn it Loose" → "Suffer from Diarrhea" (Spanish)

- Pepsi
  - "Come alive with the Pepsi generation" → "Pepsi brings your ancestors back from the grave" (Chinese)

- Perdue
  - "It takes a strong man to make a tender chicken"

  → "it takes an aroused man to make a chicken affectionate" (Spanish)

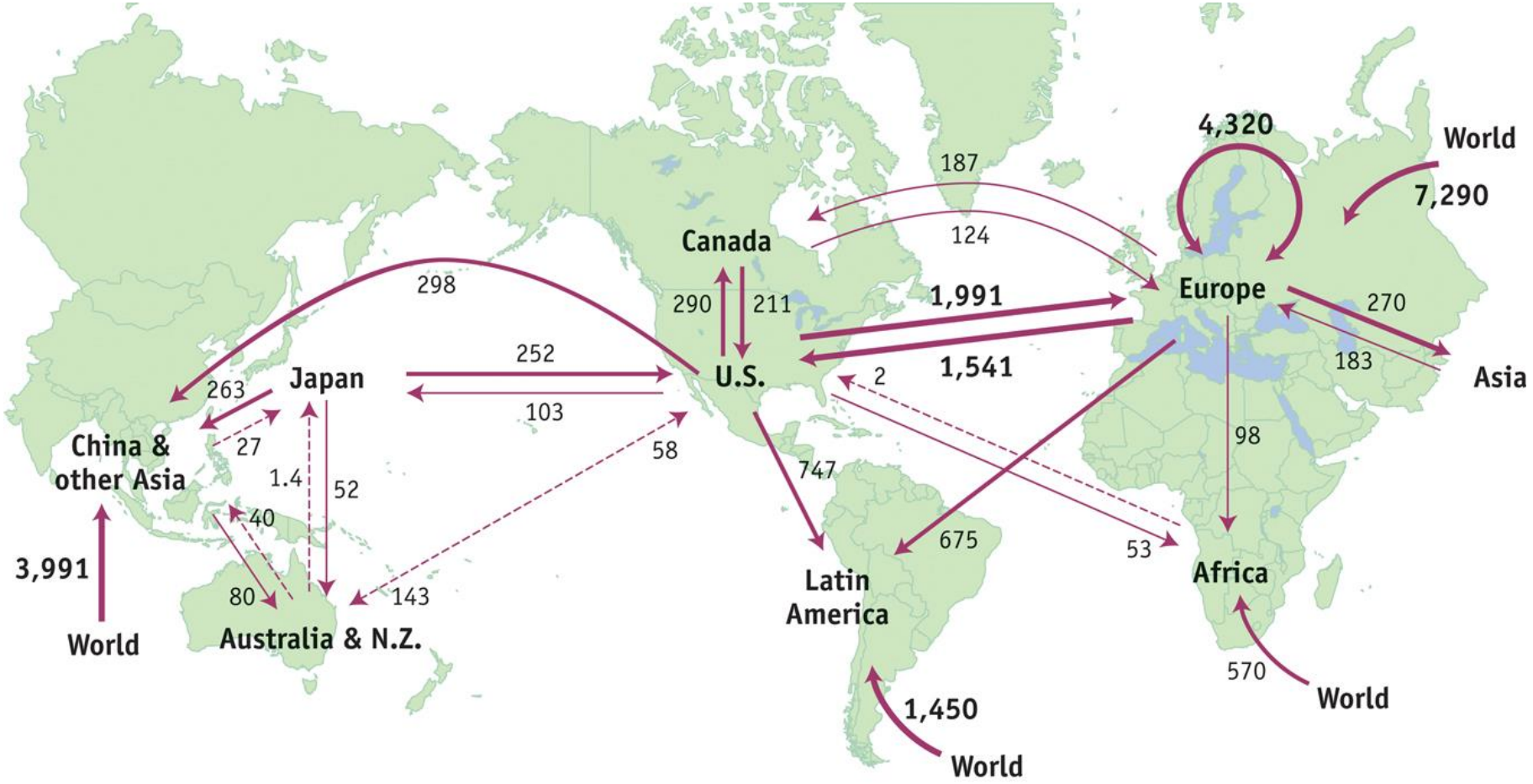
- Powergen Italia
  - First website address: www.powergenitalia.com (here)

Another misconception: FDI

Misconception: “Most FDI (foreign direct investment) goes towards developing countries such as China”

REALITY:

- It’s again mostly to and from other rich countries



Total world FDI in 2010: $19,907 billion

World FDI Stocks

- < $50 billion
- $50–200 billion
- $200–1,000 billion
- > $1,000 billion

Figure 1.6 Stock of Foreign Direct Investment, 2010

Map of Foreign Direct Investment

In 2010 more than one-third of the world flows of FDI:

- were within Europe
- or between Europe and the United States,

… and 90% of the world flows of FDI were into or out of the OECD countries.

Two main forms of Foreign Direct Investment (FDI)

1) Horizontal FDI

- when a firm from one country owns a company in another country to sell the same goods
- Tends to be between industrialized countries

2) Vertical FDI

- When a firm from a country owns a plant in another country who produced inputs for the parent company
- Parent company tends to be in industrialized country
- Affiliate tends to be in developing country

…and a HUGE misconception:

"Trade is a zero-sum game"

"There are winners and losers"

STRONG AGREEMENT AMONG ECONOMISTS:

- All countries gain from trade!

Other misconceptions:

- We'll see a wide range of results that are far from obvious and may seem counter-intuitive:
  - About the gains from trade,
  - the effect of trade on wage inequalities,
  - optimal trade policy,
  - etc.

- Most of these misconceptions come from ***partial-equilibrium*** analysis as opposed to ***general equilibrium***

  - For instance:

    The *more* productive a country, the *less* it gains from trade.

Contact

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